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SUBJECT: HONG KONG'S 2009-10 BUDGET FOCUSES ON JOBS,
FINANCIAL INNOVATION, AND CARING

REF: HONG KONG 0040

¶1. Summary: Hong Kong's Financial Secretary outlined the Special Administrative Region's new budget on February 25. The Secretary reported Hong Kong's economy has been hit hard by the global economic crisis, officially falling into recession in the third quarter of 2008. With unemployment at 4.6 percent and rising and more than 34,000 jobs lost since August 2008, the government's 2009-10 budget focuses on creating 62,000 jobs in the next three years. Hong Kong's revenue increased on the back of a good first half of 2008 and, combined with its large fiscal reserves, gives policymakers plenty of room to support the economy through additional government spending. In addition to creating new jobs, Hong Kong will seek to improve local quality of life through increased spending on building renovation, health, culture and environmental projects. Officials also plan to increase Hong Kong's competitiveness as a financial services center by revising laws to allow for negotiation of double taxation agreements and by issuing Hong Kong government bonds to facilitate the creation of a local bond market. End summary.

¶2. Hong Kong Financial Secretary John Tsang outlined Hong Kong's economic position and unveiled the government's 2009-2010 budget to the Legislative Council (Legco) on February 25. Like the rest of the region, Hong Kong has been severely affected by the economic downturn. In December and January, Hong Kong trade volumes were down 20 percent from the year before. Unemployment has risen to 4.6 percent in the three month period ending in January, with coming months expected to be worse still. Hong Kong's economy shrank by 2.5 percent in the fourth quarter of 2008 (or 3.6 percent on a seasonally adjusted basis) as trade and consumption both dropped sharply. Hong Kong, however, is in a relatively strong position to respond to the economic crisis. Banks in Hong Kong are generally well-capitalized and do not appear to be significantly exposed to toxic assets. Government revenues increased in 2008 as taxes on 2007 profits are paid in 2008. Additionally, recent boom years mean Hong Kong has sizable fiscal reserves (HKD 448.1 billion/US\$ 57.8 billion) that it can draw on to fund additional spending.

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Jobs, Jobs, Jobs
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¶3. Given concerns over rising unemployment, creating jobs is the government's top near-term priority. Tsang promised to create 62,000 job and internship opportunities over the next three years by boosting government infrastructure spending, increasing job training, renovating and repairing dilapidated buildings, hosting international and local events (including the 2009 East Asian Games), enhancing the energy efficiency of government buildings, and creating an internet safety

training program for youth.

¶4. In the medium term, Tsang promised to "consolidate Hong Kong's fundamentals" and "create a caring community" to improve both Hong Kong's economic prospects and the quality of life for residents. Tsang also promised Hong Kong would do more to promote the development of economic integration with mainland China and the region by strengthening the infrastructure links between Hong Kong, Guangdong and Macau, and by studying ways to promote closer ties with Taiwan. He noted the importance of human capital in the key sectors of Hong Kong's economy and vowed to increase funding to secondary, tertiary, and English-medium education. Hong Kong will negotiate to allow Guangdong residents easier access to Hong Kong (and Macau), expand research and development opportunities by expanding the Hong Kong science park, coordinate with Guangdong on energy and environmental policy, and promote Hong Kong as "green" city by subsidizing energy efficiency improvements in government buildings and purchasing electric cars. Finally, Tsang promised to work with China in the G-20 to improve the global regulatory framework, even as Hong Kong improves its own financial regulations.

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Issuing Bonds to Create a Bond Market

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¶5. In order to facilitate Hong Kong's development as a global financial center, the government will issue government bonds. Tsang went to great lengths to clarify that the Hong Kong government is very capable of funding its operating expenses

HONG KONG 00000343 002 OF 002

solely through tax revenues and dipping into its fiscal reserves, but emphasized that issuing government bonds will help the development of the bond market in Hong Kong. The funds raised will be deposited in an account separate from fiscal reserves and will not be used to finance spending, he said. Additional details will be determined in consultation with local financial experts and the Legco.

¶6. The government will also revise its laws to allow it to sign agreements with foreign tax jurisdictions to avoid double taxation. Hong Kong has a handful of double taxation agreements (DTAs) on the books already (reftel) but its current laws do not allow it to comply with the OECD 2004 Exchange of Information requirements demanded by many tax authorities. Following a consultation period last year, the Hong Kong government has decided to put forward appropriate amendments by mid-year to allow adoption of the more stringent standards.

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Creating a "Caring Community"

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¶7. Tsang highlighted government efforts to create a "Caring Community." Through urban renewal projects, building maintenance, conservation, and harbor beautification projects, the government will contribute to "greening" Hong Kong. Tsang promised additional funds for sports, culture and recreation, including spending HKD 53 million (US\$ 6 million) to support traditional Cantonese opera. The government will increase health spending to 17 percent of GDP by 2012 and will increase the Hospital Authority budget by HKD 2.6 billion (US\$ 335 million) by 2012. Tobacco taxes will increase by 50 percent in order to discourage smoking. Programs for child care, elderly care, women's education, support for the disabled and victims of domestic violence are all set to increase.

¶8. Tsang ended his budget address by offering to extend one-off revenue concessions to certain segments of society. Property taxes, known locally as "rates," for the second and third quarters of 2009 will be waived, up to a limit of HKD

1500 (US\$ 195) per unit per quarter. This will exempt 90 percent of households and 60 percent of commercial units from this tax during these two quarters. Government-owned rental properties will reduce rents by 20 percent, benefiting more than 17,000 tenants. The salaries tax for 2008-9 income (paid in 2009) will be reduced by 50 percent and certain government fees that were suspended last year will continue to be suspended in 2009-10.

19. Total government spending will be HKD 301.6 billion (US\$ 38.91 billion) in 2009-10 and revenue is projected to be HKD 261.7 billion (US\$ 33.77 billion), leaving a deficit this year of HKD 39.9 billion (US\$ 5.15 billion), which will be funded from Hong Kong's sizable fiscal reserves. Increased capital spending, combined with slower economic growth, will force Hong Kong to continue to run down its fiscal reserves for the next five years. However, given the size of Hong Kong's reserves, the budget deficits in coming years will still leave them with reserves sufficient to cover well over one year of government expenditures in 2014.

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